Part A: Economic and Financial Developments

Overview and Executive Summary

The economy of Bangladesh showed a mixed picture in the first quarter of FY15 (July–September, 2014). Aus rice production, the first crop of the fiscal year, met the target according to the preliminary estimate by Directorate of Agriculture Extension (DAE). But the dominant services sector depicted a mixed image during the period. Trade credit and bank advances to transport and communication sector showed higher growth while cargo handling through Chittagong port during the first quarter of FY15 showed slightly negative growth.

Among other indicators, a slow growth in ADP utilization (9.4 percent compared to the 11.7 percent growth of same period of previous fiscal year) likely to have adverse effects on consumption and investment demand. On a brighter note, remittances growth was 22.6 percent compared to a negative 8.1 percent growth in the same period of the previous fiscal year and improvement in private sector credit growth in September 2015 will boost the growth prospect.

The twelve month average CPI inflation maintained a declining trend since January 2014 and came down to 7.22 percent in September 2014, due mainly to fall in global food prices along with almost stable condition of domestic food prices. Point to point CPI inflation also went down to 6.84 percent in September 2014 from 6.97 percent at the end of June 2014 as its food inflation step down to 7.63 percent in September 2014 from 8.00 percent in June 2014. Point to point non-food inflation, however, rose to 5.63 percent in September 2014 from 5.45 percent in June 2014 due to rise in house rent, medical expenses, cost of transportation and communication etc.

The monetary stance in H1FY15 aims to bring average inflation down to 6.5% by end of FY15, while ensuring that credit growth is sufficient to stimulate inclusive economic growth. Given these objectives, BB aims to limit reserve money growth to 15.5 percent and broad money growth to 16.0 percent by December 2014. The space for private sector credit growth of 16.5 percent (including foreign borrowing by local corporates) has been kept well in line with output growth targets and is sufficient to accommodate any substantial rise in investment over H1FY15.

The overall Current Account Balance (CAB) recorded a deficit of USD 357.0 million in the first quarter of FY15 in contrast to a surplus of USD 588.0 million in Q1FY14. The CAB was negative for the third consecutive quarter particularly owing to import growth outstripping export growth. Import payments in Q1FY15 grew by 13.6 percent while export earnings increased very insignificantly by 0.9 percent, compared with the corresponding quarter of the previous year. Remittance inflows increased by 22.7 percent in Q1FY15 compared to a negative *growth of (- 8.1 percent) during Q1FY14. Despite a notable remittance growth in Q1FY15, the trade balance remained negative registering about a trade deficit of USD 2.4 billion. However, secondary income recorded a surplus of USD 4110.0 million underpinned by the growth in remittances in contrast to deficits incurred by services (USD 1.33 billion) and primary income (USD 738.0 million).*

Preliminary estimates demonstrate that total revenue increased by 10.6 percent to Tk. 358.4 billion whereas total expenditure grew by 40.0 percent to Tk.479.0 billion during Q1FY15 compared with Q1FY14. The faster expenditure growth relative to revenue contributed to fiscal deficit at Tk.120.6 billion during Q1FY15 compared with Tk.18.1 billion in Q1FY14. This quarterly fiscal deficit was primarily financed by non-bank sources due to the increased demand for National Savings Certificates.

The banking sector indicators showed a mixed trend during Q1FY15 compared to the previous quarter performances. The ratio of gross non-performing loans (NPL) to total outstanding loans increased to 11.6 percent at the end of Q1FY15 from 10.8 percent at the end of Q4FY14. The ratio of net NPL of the sector also increased from 3.9 percent at the end of June 2014 to 4.3 percent at the end of September 2014 due mainly to increase of NPL. Provision shortfall situation of the sector as a whole improved which decreased from Tk.40.0 billion at the end of June 2014 to Tk. 29.0 billion at the end of September 2014. During Q1FY15, the capital adequacy ratio (CAR) decreased marginally to 10.6 percent from 10.7 percent in Q4FY14. Among the profitability measures, return on asset (ROA) in the banking sector declined from 0.9 percent at the end of December 2013 to 0.6 percent at the end of June 2014 due to maintaining higher provision for the increased NPL and the net losses made by SOCBs. Return on equity (ROE) of the banking industry also decreased to 8.4 percent at the end of June 2014 from 11.1 percent at the end of December 2013. The falling interest rate spread during Q1FY15 was a positive development.

Finally, the FY15 inflation target announced in MPS (July-December, 2014) is 6.50 percent. The average inflation rate recorded in December 2014 is 6.99 percent which is higher than the target rate. However, average inflation has been falling gradually from the same month of last year amid some fluctuations. Price pressures are expected to moderate with a better crop outlook, and a continued accommodative monetary policy stance of Bangladesh Bank.

I. Developments in the real economy

1.1 According to the data from Directorate of Agriculture Extension (DAE), the target for total cereal food grain production for FY15 has been set at 38.26 million metric tons (MMT) which was 0.21 percent higher than the actual production of FY14, while the target for area of cultivation declined by 1.49 percent. After a year of bumper harvest, the target for total rice production, the lion share of total cereal crop, for FY15, has been set at 34.40 MMT, which is marginally lower than the actual production of the previous fiscal year (34.36 MMT). The target for *aus* rice production, the first crop of the fiscal year, is set at 2.43 MMT (on 1.16 million hectares of land), 4.39 percent higher than the actual production of FY14. Against this target, DAE preliminary estimate shows that 2.41 MMT *aus* has been produced in the current fiscal year. The target for *aman* production, the second largest crop of the fiscal year has been set at 13.00 MMT, which is slightly lower (0.21 percent) than the actual production of FY14. The target for *boro* production, the largest crop of the country, is set at 18.98 MMT, 0.16 percent lower than the actual production of 19.01 MMT in FY14. Wheat production target has been set at 1.33 MMT for FY15, a 2.38 percent high compared to the actual productions of FY14, while the production target for maize production remains same as the actual production of 2.52 MMT in the previous fiscal year. After a year of bumper production, the target for potato production is set at somewhat (-1.8 percent) lower level of 8.9 MMT on 0.45 million hectares of land for FY15.

Chart 1.1: Growth of Real GDP

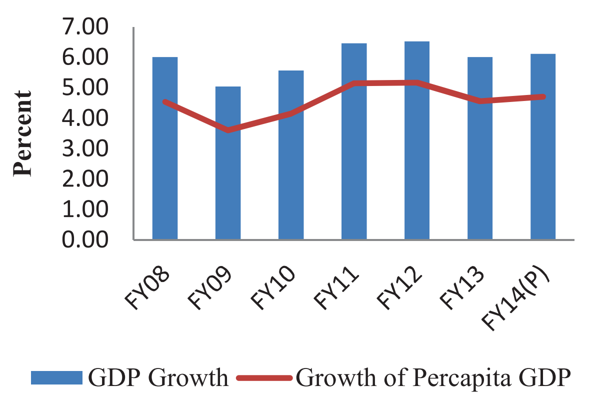
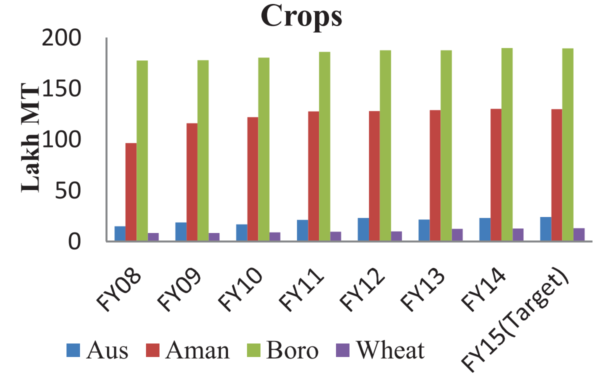


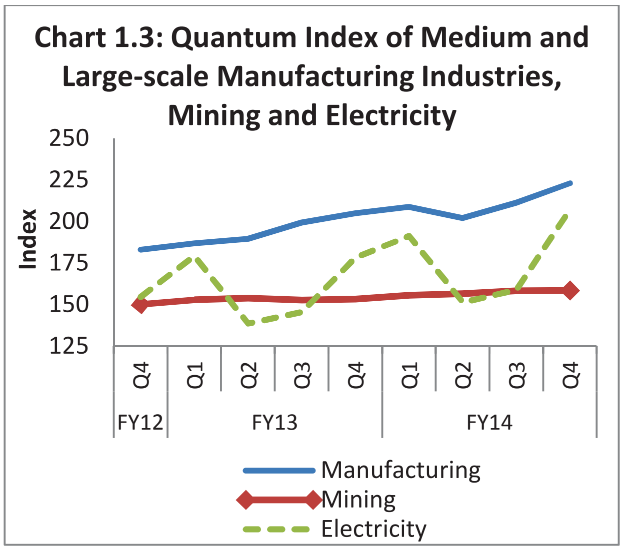
Chart 1.2: Production of Major Crops

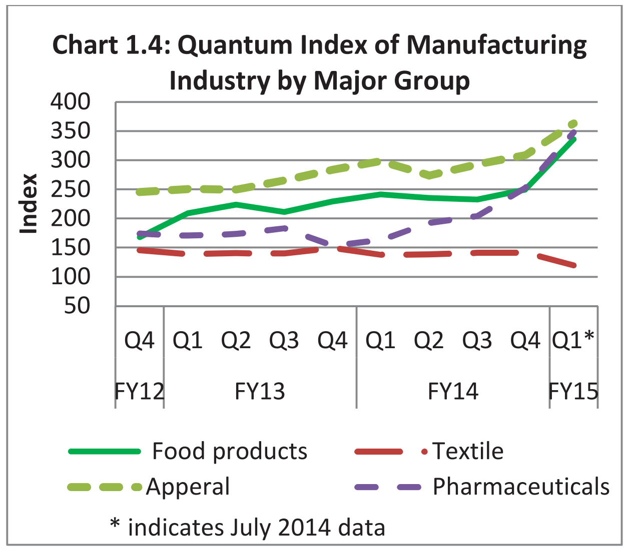


* Aus production for FY15 indicates provisional estimate by DAE

1.2 The quantum index of large and medium scale industries, which proxies for industrial performance in the first quarter of FY15, registered a 10.79 percent growth (year on year) in July

2014 compared to14.90 percent growth in July 2013[1].It may be mentioned that these industries experienced 8.89 percent in the last quarter of previous fiscal year. In July 2014, the growth of these industries were largely due to the high growth of pharmaceuticals and medicinal chemical (83.04 percent), fabricated metal products (52.19 percent), food products (38.54 percent), and non-metalic mineral products (11.40 percent). Among others in the large and medium scale industries, electricity and mining grew by 16.25 percent and 3.30 percent respectively in the Q4FY14. However, low growth of cement production (5.74 percent) and moderate growth of iron and steel production (9.51 percent) in Q4FY14 indicate decelerating growth of the construction activities in the economy.





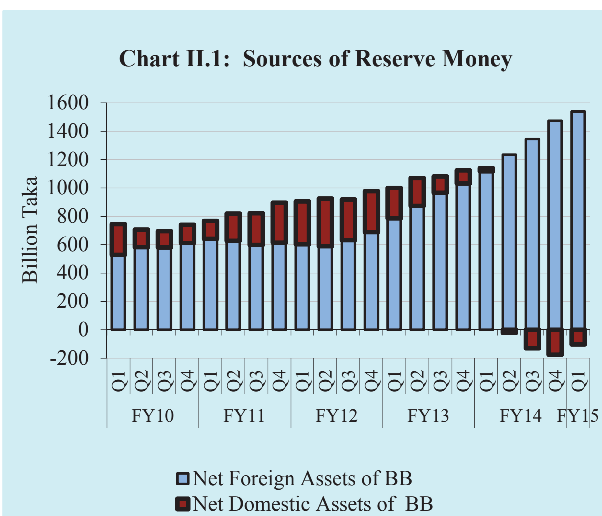
1.3 Though service sector data is available only on annual basis, a number of proxy indicators (such as trade financing, bank advances to transport and communication sector, cargo handled through Chittagong port etc.) reflect a mixed picture of the service sector growth during the first quarter of FY15. Data on bank advances (table 1.9 in appendix) shows that credit (outstanding) to trade sector increased by 15.18 percent in the Q1FY15 compared to 7.65 percent rise in the Q1FY15. At the same time, bank advances to transport and communication sector registered 9.09 percent positive growth compared to a negative growth of 9.43 percent in the same period of previous fiscal year. On the other hand, cargo handled through Chittagong port declined by 0.16 percent during the Q1FY15 compared to 10.70 percent during the Q1FY14.

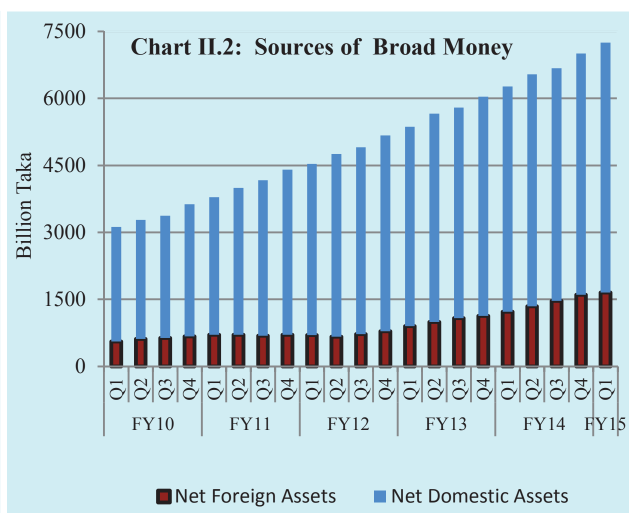
[1] Bangladesh Bureau of Statistics is officially responsible for publishing data on industrial production of the country. In its website, latest official data is available for June, 2014. But, data for July, 2014 has been collected from Major Economic Indicator, Bangladesh Bank (http://www.bb.org.bd/pub/monthly/selectedecooind/magecoinddec2014.pdf).

II. Money and Credit Market Development

2.1 The monetary stance in H1FY15 aims to bring average inflation down to 6.5% by end of FY15, while ensuring that credit growth is sufficient to stimulate inclusive economic growth. Given these objectives, BB aims to limit reserve money growth to 15.5 percent and broad money growth to 16.0 percent by December 2014. The space for private sector credit growth of 16.5 percent (including foreign borrowing by local corporate) has been kept well in line with output growth targets and is sufficient to accommodate any substantial rise in investment over H1FY15. At the same time, significant liquidity in the banking system has led to a sharp rise in reverse repo operations in H2FY14 with consequent costs to BB and ultimately the taxpayer. For both these reasons BB decided to raise the Cash Reserve Requirement (CRR) by 50 basis points in June 2014.

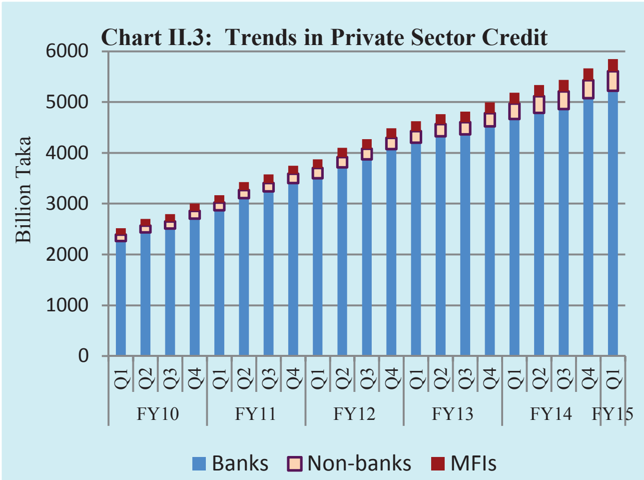
2.2 In Q1FY15 broad money (M2) growth was 15.7 percent compared with 16.1 percent in FY14 and 16.9 percent in Q1FY14 but remained marginally higher than the programmed level of 15.5 percent for the first quarter of FY15. The growth in private sector credit slowed a bit little to 12.2 percent in September 2014 from 12.3 percent in June 2014, and remained lower than the quarterly target growth of 13.0 percent though the growth was higher than the actual growth of 10.9 percent a year earlier. Growth of credit to the public sector was 12.7 percent in Q1FY15 compared with 8.9 percent in FY14 and 13.3 percent in Q1FY14 while programmed growth for the first quarter of FY15 was 9.1 percent. Net Foreign Asset (NFA) grew by 35.4 percent in September 2014, which was 5.8 percentage points lower than the growth in previous quarter and slightly lower than Q1FY14.



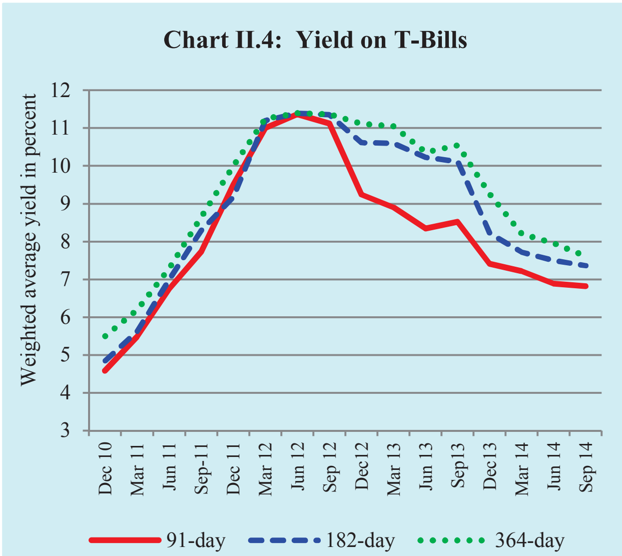


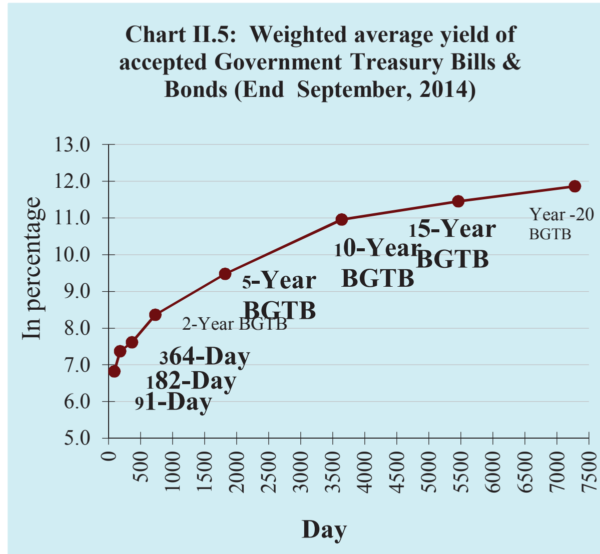
2.3 A look at the components of M2 shows that currency, demand deposits and time deposits increased by 26.2 percent, 15.1 percent and 14.3 percent (y-o-y) respectively during Q1FY15 compared with the increase of 13.0 percent, 9.0 percent and 18.4 percent respectively during the same period of the preceding year. Narrow money or M1 grew by 21.3 percent in Q1FY15 which was 11.2 percent in Q1FY14 due to higher growth in both currency and demand deposits. However, the money multiplier (M2/RM) decreased to 5.0 in Q1FY15 from 5.5 in Q1FY14 reflecting the relatively slower expansion of M2.

2.4 Reserve money (RM) grew by 26.0 percent (y-o-y) in Q1FY15 compared with 14.1 percent (y-o-y) growth during the same period of the preceding year. This was due to the 37.9 percent increase in NFA of BB which resulted from the foreign exchange purchase of USD 1210.0 million by BB in order to keep the nominal exchange rate relatively stable and to protect export competitiveness. However, the resulted taka liquidity was partially sterilized by issuing BB bills. Net domestic assets of Bangladesh Bank nosedived during this quarter due to a large decline in net borrowing of the government from Bangladesh Bank during the quarter.

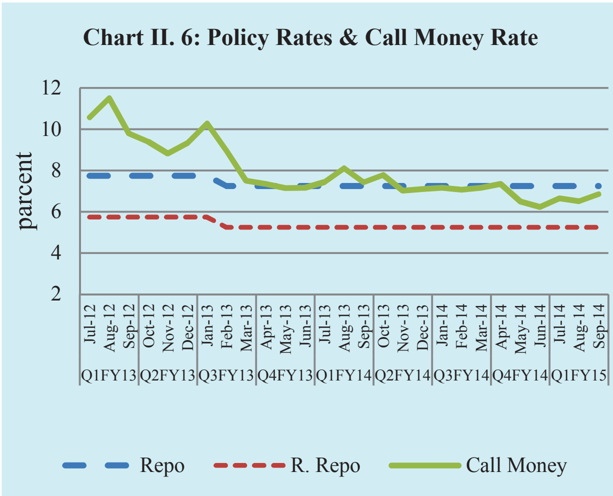


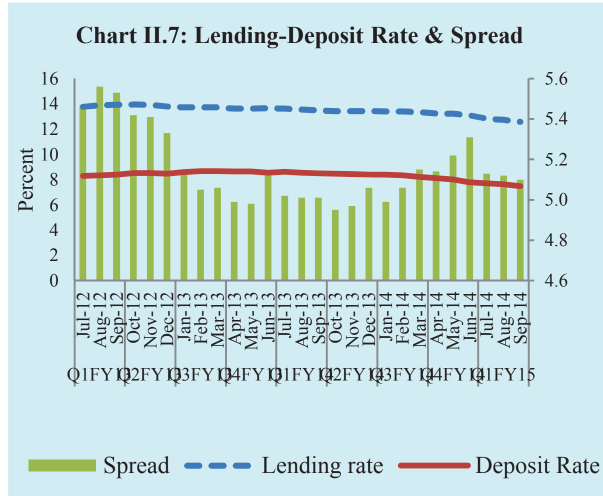
2.5 In Q1FY15, private sector credit (including banks, non-banks and micro-finance institutions) grew by 13.0 percent compared with 11.9 percent in Q1FY14. Bank advances to industry grew by 15.9 percent at the end of September 2014 due to a sharp growth in working capital financing by 48.7 percent over this period. However, industrial term loan declined further by 8.4 percent in Q1FY15 compared to 11.5 percent decline in the same period of the preceding year. Bank advances to the construction and transport sectors grew by 22.4 and 9.1 percent respectively at the end of Q1FY15 compared with a shrink by 6.2 percent and 9.4 percent respectively at the end of Q1FY14. In the agriculture sector the supply of credit increased by 5.7 percent at the end of Q1FY15 (of which advances to crops increased by 4.2 percent while others went up by 22.1 percent). Growth of advances to trade & commerce, and consumer finance sectors were 15.2 percent and 4.3 percent respectively at the end of September 2014 compared with the growth of 7.7 percent and 18.3 percent respectively at the end of September 2013. The highest share of bank advances went to the trade sector (38.9 percent) followed by the industry (35.6 percent) and construction sector (9.3 percent) (Table I.9). The overall disbursements of industrial term lending by Banks and NBFIs grew by 44.2 percent, and stood at Tk. 128.1 billion at end Q1FY15, from Tk. 88.8 billion in Q1FY14.





2.6 Overall yields on short term treasury bills e.g., 91-day decreased to 6.82 percent at the end of September 2014 from 8.52 percent at the end of September 2013. The rates of 182-day and 364-day treasury bills decreased notably in Q1FY15. The rates declined to 7.37 percent and 7.61 percent respectively at end of September 2014 from 10.12 percent and 10.55 percent respectively at the end of September 2013. The rate of 30-day Bangladesh Bank bill fell to 5.43 percent in Q1FY15 from 7.70 percent during the same quarter of the previous year. This was due to a significant increase in the appetite for short-term securities given their relatively attractive yields and growing liquidity in banks. Two-year and five-year long-term treasury bonds yields decreased to 8.36 percent and 9.48 percent respectively at the end of September 2014 from 10.90 percent and 11.78 percent at the end of the same period of the preceding year (Table II.3). The yields on 10-year, 15-year and 20-year BGTB also decreased from 12.22 percent, 12.42 percent and 12.48 percent respectively at the end of September, 2013 to 10.96 percent, 11.45 percent and 11.86 percent respectively at the end of September, 2014.





2.7 The repo and reverse repo rates remained unchanged at 7.25 percent and 5.25 percent respectively during the period under consideration. However, the call money rate dropped from 7.42 percent recorded at the end of September 2013 to 6.86 percent at the end of September 2014, reflecting a comfortable liquidity condition in the money market. The spread between lending and deposit rates widened in Q4FY14 to 5.40 percent from 5.09 percent in Q1FY14 although it came down to 5.10 percent at the end of Q1FY15.

III. Fiscal Developments

3.1 Preliminary estimates demonstrate that total revenue increased by 10.6 percent to Tk. 358.4 billion whereas total expenditure grew by 40.0 percent to Tk. 479.0 billion during Q1FY15 compared with Q1FY14. The faster expenditure growth relative to revenue contributed to fiscal deficit at Tk. 120.6 billion during Q1FY15 compared with Tk. 18.1 billion in Q1FY14. This quarterly fiscal deficit was primarily financed by non-bank sources due to the increased demand for National Savings Certificates (Table III.1, Chart III.1, and Chart III.2).

Chart III.1: Trends in Government Revenue and Expenditure

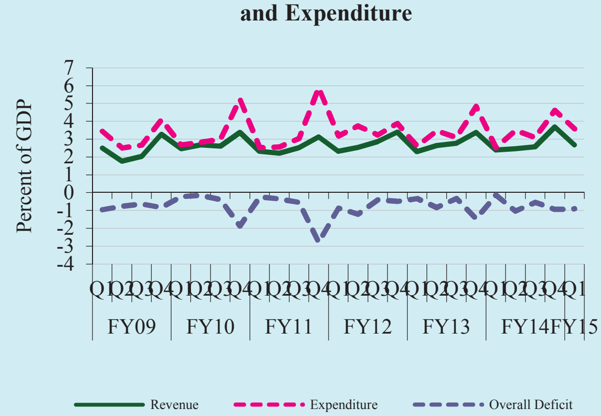
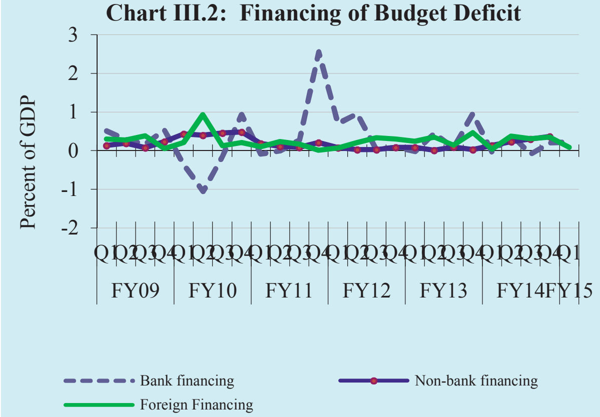


Chart III.2: Financing of Budget Deficit



3.2 The national budget for FY15 estimated overall revenue and expenditure to be 13.7 percent and 18.7 percent of GDP respectively compared with 11.1 percent and 13.7 percent in FY14 generating a fiscal deficit of 5.0 percent of GDP in FY15 compared with revised budget deficit of 4.4 percent of GDP in FY14. Total deficit financing was set at Tk.675.0 billion (excluding grants) for FY15, of which TK. 432.8 billion was projected to be financed by domestic borrowing including bank financing of TK. 312.2 billion (66.2 percent higher than actual level of FY14), non-bank financing of TK. 120.6 billion, and TK. 242.8 billion from foreign sources including foreign grants of Tk. 62.06 billion.

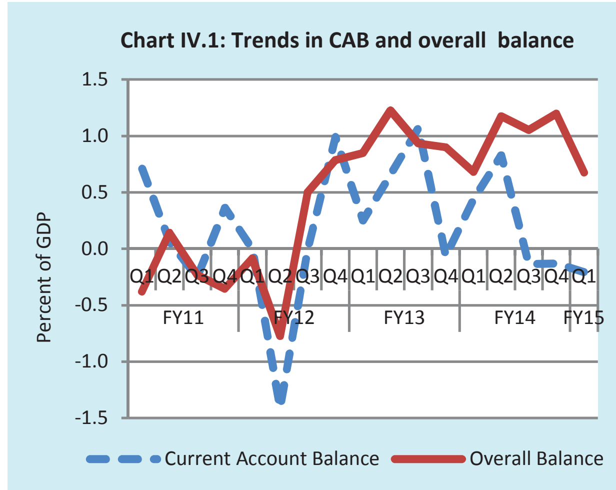
3.3 During Q1FY15, revenue collection of NBR increased by 13.6 percent to TK. 282.4 billion from the level of Q1FY14, which was only 18.9 percent of the annual target of FY15. Tax revenue collection from value added tax (VAT), income tax , custom duties, and other sources increased by 12.9 percent, 12.2 percent, 9.1 percent and 21.6 percent respectively during the quarter under review over the level of Q1FY14. The FY15 budget projected the total revenue of Tk. 1829.5 billion which was 21.8 percent higher than actual revenue of FY14. Of this, Tk. 1497.2 billion was NBR revenue (24.2 percent higher than that of FY14) and Tk. 55.72 billion was non-NBR revenue. Current expenditure and annual development program (ADP) expenditure were set at TK. 1282.3 billion (9.6 percent of GDP) and TK. 803.2 billion (6.0 percent of GDP), which were 35.8 percent and 34.8 percent respectively higher than the actual level of FY 14. Economic analysis of total expenditure of the FY15 budget shows that the largest allocations are likely to go to the heads of ‘public administration (15.3%)’, ‘education and information technology (13.1%)’, ‘interest payments (12.4%)’, ‘transport and communication (9.8%)’, ‘agriculture (7.6%)’, ‘local government and rural development (7.1%)’, and ‘defense services (6.6%)’.

3.5 During Q1FY15, preliminary estimates of total expenditure increased by 40.0 percent to Tk. 479.0 billion (19.1 percent of yearly target) from the level of Q1FY14. The ADP expenditure stood at TK. 75.9 billion during Q1FY15 compared with Tk. 69.9 billion of Q1 FY14. The utilization rate for Q1FY15 is only 9.4 percent of annual ADP target which necessitate to speed up qualitative ADP expenditure to meet annual target.

3.6 Budget deficit reached Tk.120.6 billion (0.9 percent of GDP) in Q1FY15 compared to Tk. 18.1 billion (0.1 percent of GDP) in Q1FY14. Deficit financing during the quarter under review amounted to Tk. 109.2 billion from domestic sources that included bank financing of Tk. 30.7 billion and nonbank financing of Tk. 78.5 billion while the remaining amount of Tk.11.4 billion was from foreign sources. Higher rate of return on government savings certificate made these instruments extremely attractive to the people as a mode of savings.

IV. External Sector Developments

4.1 The overall current account balance (CAB) recorded a deficit of USD 357.0 million in the first quarter of FY15 in contrast to a surplus of USD 588.0 million in Q1FY14. The CAB was negative for the third consecutive quarter particularly owing to import growth outstripping export growth. Import payments in Q1FY15 grew by 13.6 percent while export earnings increased very insignificantly by 0.9 percent, compared with the corresponding quarter of the previous year. Remittance inflows increased by 22.7 percent in Q1FY15 compared to a negative growth of (- 8.1 percent) during Q1FY14. Despite a notable remittance growth in Q1FY15, the trade balance remained negative registering about a trade deficit of USD 2.4 billion. However, secondary income recorded a surplus of USD 4110.0 million underpinned by the growth in remittances in contrast to deficits incurred by services (USD 1.33 billion) and primary income (USD 738.0 million).



4.2 The combined capital & financial account recorded a surplus of USD 1.82 billion in Q1FY15 which was remarkably higher than the surplus of USD 211.0 million in Q1FY14. Of this, the financial account posted a surplus of USD 1.79 billion in Q1Y15, which again, was notably higher than the surplus of USD 95.0 million in Q1FY14. In contrast, the capital account surplus decreased to USD 38.0 million in Q1FY15 from USD 116.0 million in Q1FY14.

The overall balance of payment (BOP) posted a surplus of USD 1.18 billion in Q1FY15 along with a reserve of foreign exchanges of USD 22.16 billion at the end of September 2014 (Table IV.1).

4.3 Total foreign aid increased by 25.1 percent to USD 528.7 million in Q1FY15 from USD 422.7 million in Q1FY14. Of the total aid, USD 470.2 million was disbursed as MLT loan in Q1FY15, whereas USD 298.4 million was disbursed under the same heading in Q1FY14. Grants decreased from USD 124.3 million to USD 58.5 million during the similar periods. In Q1FY15, amortization for Bangladesh accounted for the payment of USD 383.3 million, of which USD 322.9 million was paid as principal. As a result, net foreign financing in Q1FY15 was USD 205.8 million which was 123.7 percent larger than USD 92.5 million in same quarter of the preceding year (Table IV.8)

Chart IV.2: Exchange Rate Movements

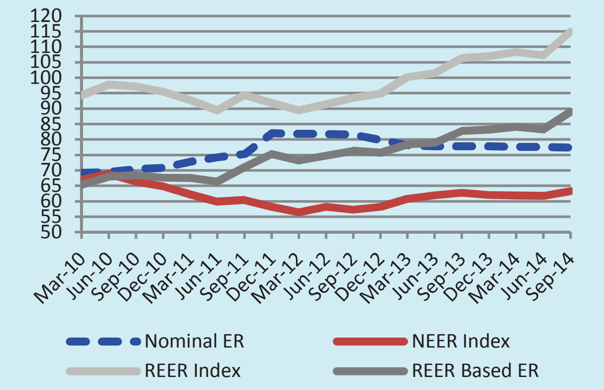
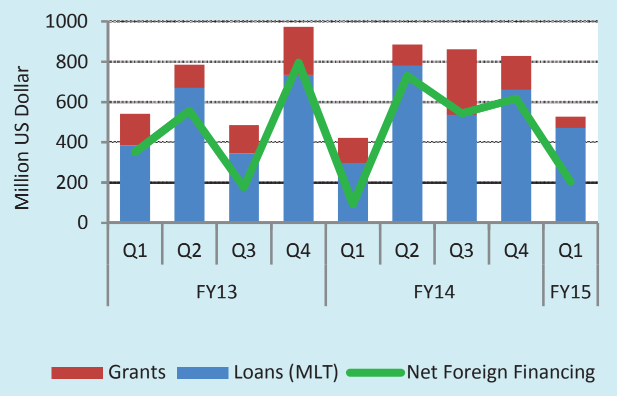


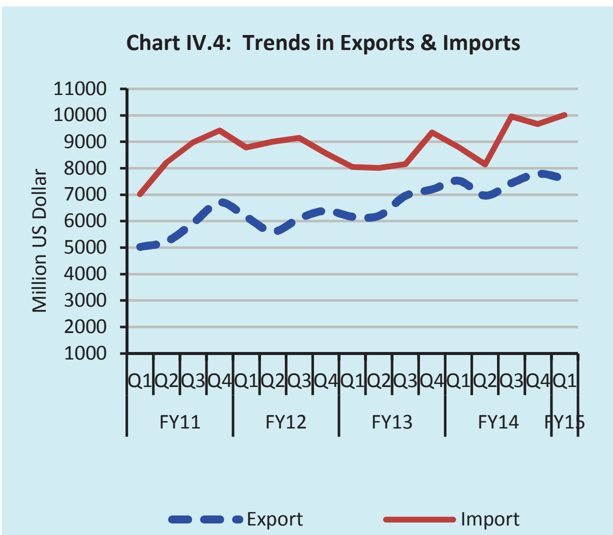
Chart IV.3: Trends in Foreign Aid Inflow

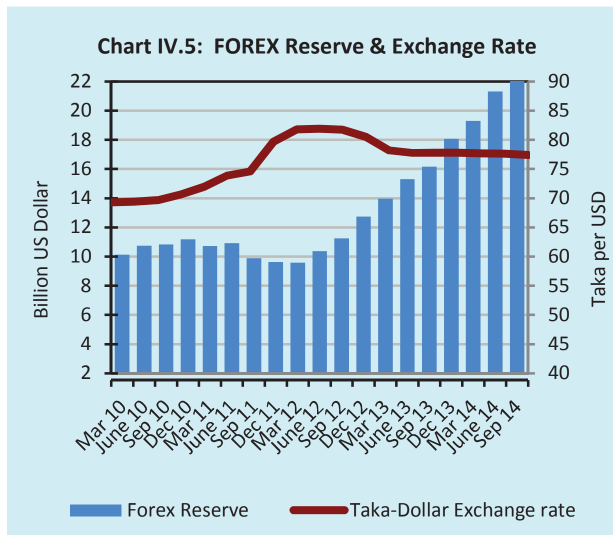


4.4 The foreign exchange market remained mostly stable and Taka appreciated (by 0.45 percent) against US dollar during Q1FY15. Bangladesh Bank continued its intervention in the domestic foreign exchange market with a net purchase of foreign currencies amounting of USD 1.21 billion during Q1FY15. The nominal exchange rate decreased to Tk. 77.40 per US dollar in September 2014 from Tk. 77.63 per US dollar in June 2014, while the REER based exchange rate increased to Tk. 88.89 per USD at the end of September 2014 from Tk. 83.22 per USD at the end of June 2014.

4.5 According to the Export Promotion Bureau (EPB) data, export earnings increased by 0.9 percent to USD 7.70 billion in the first quarter of FY15 compared to USD 7.63 billion in Q1FY14. Export of woven garments decreased by 2.70 percent in Q1FY15 compared to the corresponding quarter of FY14 as export to European countries (-0.10 percent) and to USA (-8.83 percent) both decreased. Export of knitwear products increased by 3.5 percent during the same period as a fall in export earnings from USA (-4.94 percent) was mostly offset by an increase in exports to European countries (+4.81 percent). Among other major export items, earnings from jute goods decreased by 3.5 percent while that of frozen shrimps and fish increased by 3.0 percent in Q1FY15 over the corresponding quarter of the previous year. Among non-traditional markets, RMG export to China (+39.4 percent), Republic of Korea (+36.9 percent), Brazil (+26.3 percent) increased during Q1FY15 over Q1FY14. Export of non-RMG products increased to India (77.8 percent), China (+19.9 percent) in Q1FY15. (Table IV.2 and IV.5)

4.6 Import payments (according to banking sector data) rose by 6.1 percent to USD 10.35 billion in Q1FY15 compared to USD 9.76 billion in Q1FY14. Import of food-grains decreased by 29.5 percent from USD 432.2 million in Q1FY14 to USD 304.6 million in Q1FY15. Import of rice was USD 88.9 million during Q1FY15 which was 66.2 percent higher than USD 53.5 million in Q1FY14. Wheat import decreased by 43.0 percent from USD 378.7 million in Q1FY14 to USD 215.7 million in Q1FY15. Import of other food items decreased by 10.9 percent from USD 969.4 million in Q1FY14 to USD 863.3 million in Q1FY15. Among the other food items, the import of sugar (+12.9 percent), spices (+37.7 percent), and milk & cream (+49.6 percent) increased, while edible oil (-16.6 percent) and pulses (-57.1 percent) decreased in Q1FY15 over Q1FY14 (Table IV.3).





4.7 Imports of intermediate and consumer goods increased by 13.5 percent to USD 5.04 billion in Q1FY15 from USD 4.44 billion in Q1FY14. Among the intermediate goods, imports of crude petroleum increased by 139.8 percent, POL by 49.3 percent, yarn by 14.5 percent, plastic and rubber articles thereof by 11.6 percent, while imports of clinker decreased by 9.5 percent, fertilizer by 22.9 percent, raw cotton by 2.9 percent, textile and articles thereof by 3.0 percent. On the other hand, imports of capital machinery amounted to USD 3.44 billion in Q1FY15 recording a growth of 5.6 percent over USD 3.34 billion in Q1FY14 (Table IV.3).

4.8 The opening of import LCs increased by 12.8 percent from USD 9.6 billion in Q1FY14 to USD 10.83 billion in Q1FY15, of which consumer goods increased by 25.2 percent, capital machinery by 14.1 percent, industrial raw materials by 13.2 percent, while petroleum and petroleum products declined by 18.5 percent, machinery for miscellaneous industries by 13.8 percent, and intermediate goods by 4.1 percent (Table IV.9).

4.9 The inflow of workers' remittances increased by 22.6 percent to USD 4.01 billion in Q1FY15 compared to 3.27 billion in Q1FY14. The share of inward remittances from the Gulf region during this quarter was 57.4% of the total inward remittances (amounting about 2.3 billion). A country-wise break-up of remittances shows that remittances from Saudi Arabia increased by USD 139.0 million, from UAE by USD 103.2 million, from Malaysia by USD 114.3 million, and from USA by USD 118.9 million (Table IV.4). On the other hand, overseas employment for Bangladeshi workers increased marginally in Q1FY15 as a total of 100,491 Bangladeshi migrated compared to 100,249 in the corresponding quarter of FY14.

V. Price Developments

5.1 The twelve month average CPI inflation maintained a declining trend since January 2014 and came down to 7.22 percent in September 2014, due mainly to fall in global food prices along with almost stable condition of domestic food prices. Point to point CPI inflation also went down to 6.84 percent in September 2014 from 6.97 percent at the end of June 2014 as its food inflation step down to 7.63 percent in September 2014 from 8.00 percent in June 2014. Point to point non-food inflation, however, rose to 5.63 percent in September 2014 from 5.45 percent in June 2014 due to rise in house rent, medical expenses, cost of transportation and communication etc.

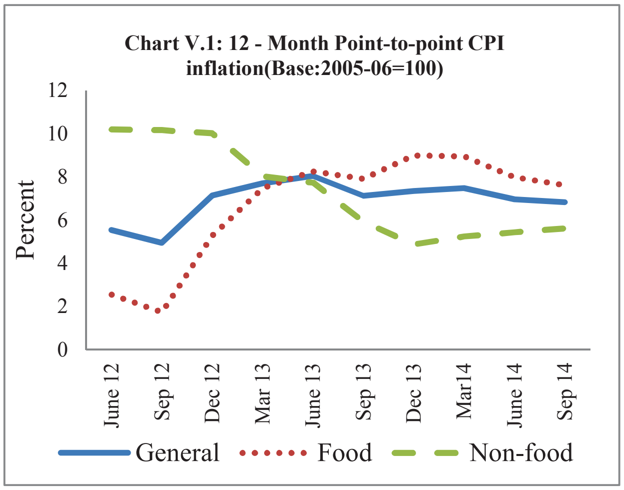
5.2 Point to point CPI inflation in rural areas slightly rose from 6.73 percent in June 2014 to 6.75 percent in September 2014 but it declined as compared to 6.83 percent in August, 2014. On the other hand, 12- month average CPI rural inflation have been declining since January 2014 and reached 7.02 percent in September 2014 due mainly to fall in non food component . Point to point CPI inflation in urban areas declined to 7.02 percent in September 2014 from 7.42 percent in June 2014 due to fall in food inflation. Similarly, average urban inflation declined to 7.60 percent in September 2014 from 7.89 percent in June 2014 due to fall in both food and non-food inflation.

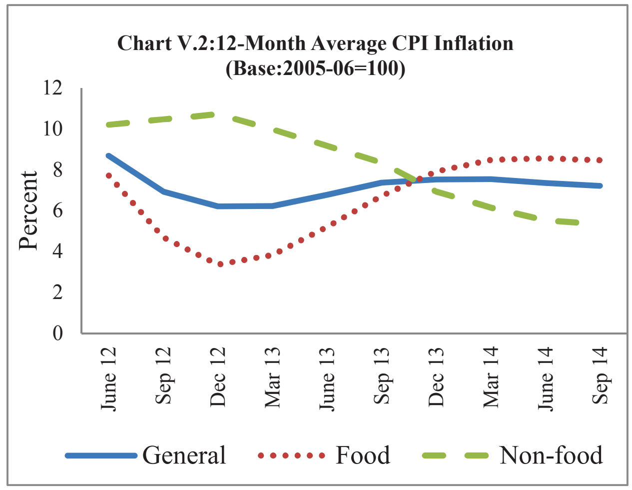
Table 5.1: Contribution @ of Food and Major Non-Food Items / Groups in CPI inflation(Point to Point)
Base Year 2005-06: 100

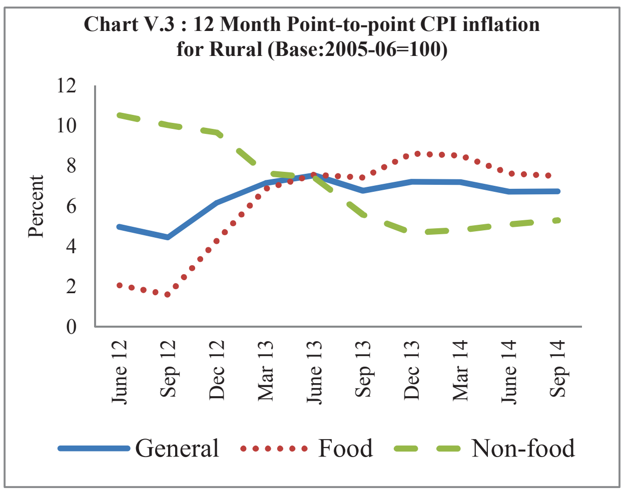
Months	Food beverage & tobacco	Clothing & Footwear	Gross rent, Fuel & Lighting	Furniture, Furnishing & Other	Medical care and Health Expenses	Transport & Communications	Recreation, Entertain-ment, Education	Misc. Goods & Services	Non-food
Weight	56.18	6.84	14.88	4.73	3.47	5.8	4.28	3.82	**43.82**
Sep-13	**63.54**	8.01	8.45	5.00	0.86	5.40	4.18	4.55	**36.46**
Oct-13	**68.48**	7.16	8.14	3.83	1.13	4.20	3.60	3.46	**31.52**
Nov-13	**68.63**	7.43	8.29	3.64	1.21	4.29	3.40	3.11	**31.37**
Dec-13	**70.59**	6.94	8.06	3.25	1.22	3.96	3.07	2.90	**29.41**
Jan-14	**67.34**	8.48	12.20	3.41	1.49	3.02	1.45	2.62	**32.66**
Feb-14	**68.07**	8.29	11.96	3.21	1.46	3.07	1.40	2.54	**31.93**
Mar-14	**68.72**	7.90	11.80	2.93	1.46	3.11	1.60	2.48	**31.28**
Apr-14	**68.80**	8.00	11.70	2.48	1.50	3.35	1.59	2.58	**31.20**
May-14	**69.41**	6.72	11.74	2.81	1.54	3.37	1.59	2.82	**30.59**
Jun-14	**65.42**	8.21	13.63	2.92	1.65	3.56	1.67	2.96	**34.58**
Jul-14	**64.15**	8.86	14.05	2.59	1.63	4.10	1.69	2.94	**35.85**
Aug-14	**63.03**	8.71	15.05	2.52	1.57	4.86	1.33	2.93	**36.97**
Sep-14	**63.28**	8.60	15.03	1.88	1.80	5.96	1.40	2.04	**36.72**

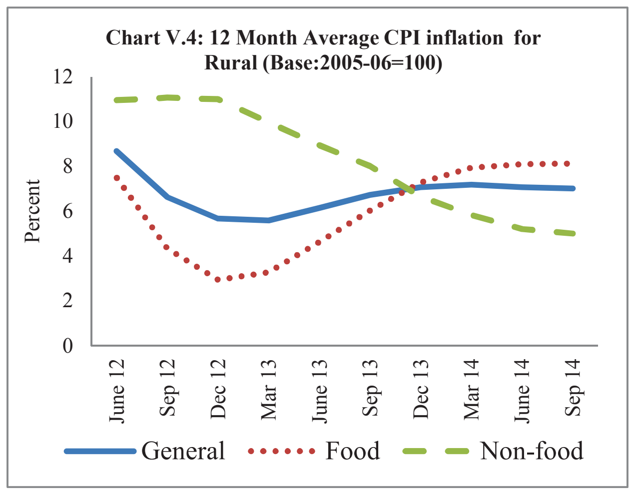
$@\text{Contribution of ith Group} = \left(\frac{\text{Inflation in ith group} * \text{Weight of ith group in CPI basket}}{\text{Headline inflation}}\right) \times 100$

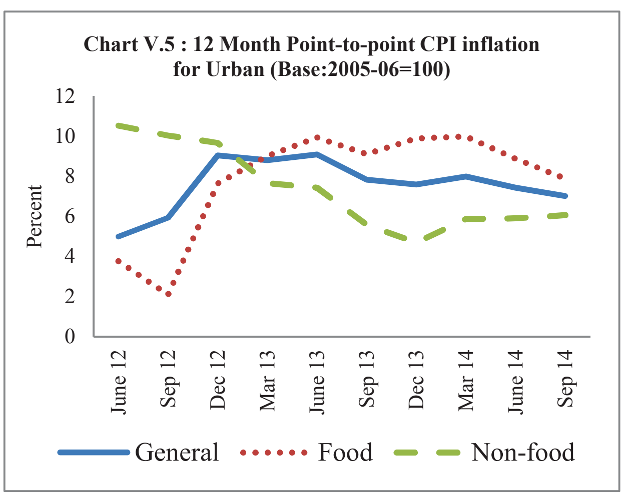
Table 5.1 shows that the contribution of food inflation to point-to-point CPI inflation is declining while that of non food inflation is increasing in the last couple of months.

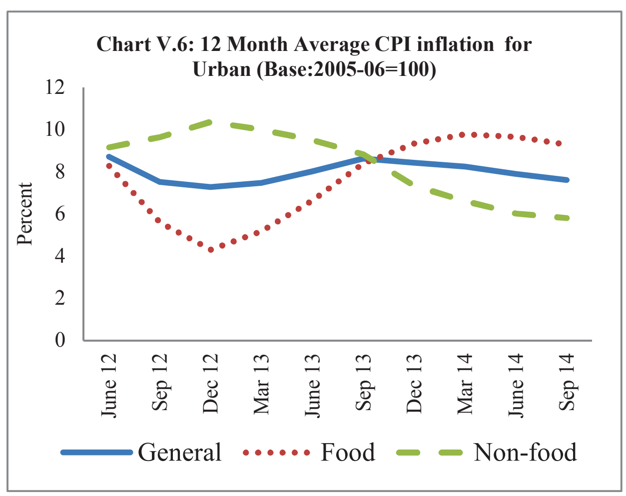




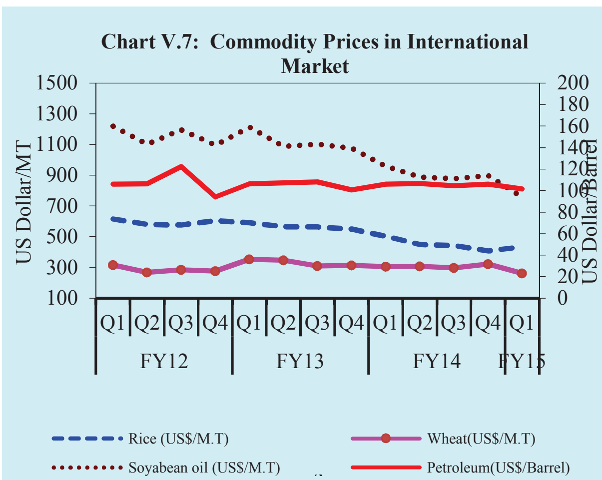


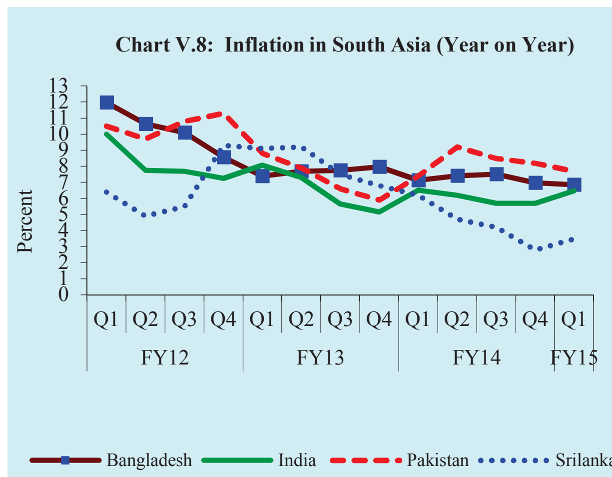






5.3 IMF primary commodity prices data revealed that y-o-y global CPI inflation faced a negative situation (-5.30 percent) in FY15Q1 as compared to 3.07 percent during FY14Q4, due to ample supply amid weak demand in the most sectors. However, Point-to-point CPI inflation in our neighboring South Asian countries exhibited a mixed trend during the quarter under review. CPI inflation in India declined to 6.46 percent in September 2014 from 7.46 percent in June 2014. WPI inflation in India also experienced a significantly decline to 2.38 percent in September 2014 from 5.66 percent in June 2014. Similarly, CPI inflation in Pakistan fell to 7.7 percent in September 2014 as compared to 8.2 percent in June 2014 while in Sri-Lanka it rose to 3.5 percent in September 2014 from 2.8 percent at the of June 2014.



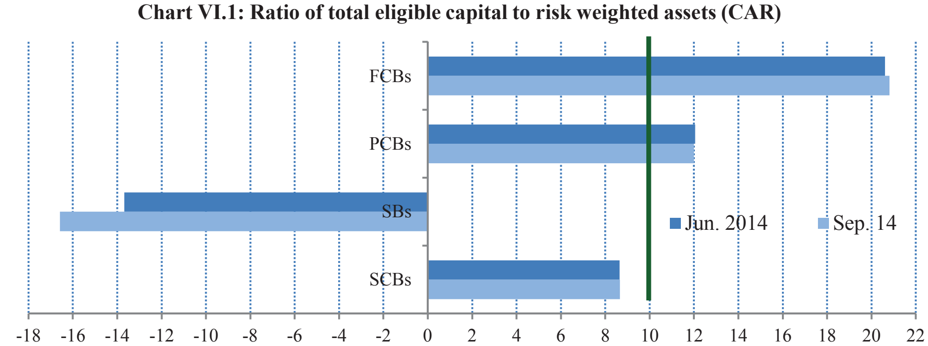


VI. Banking Sector Performance

6.1 The banking sector indicators showed a mixed trend during Q1FY15 compared to the previous quarter performances. The ratio of gross non-performing loans (NPL) to total outstanding loans increased to 11.6 percent at the end of Q1FY15 from 10.8 percent at the end of Q4FY14. The ratio of net NPL of the sector also increased from 3.9 percent at the end of June 2014 to 4.3 percent at the end of September 2014 due mainly to increase of NPL. Provision shortfall situation of the sector as a whole improved which decreased from Tk.40.0 billion at the end of June 2014 to Tk. 29.0 billion at the end of September 2014. During Q1FY15, the capital adequacy ratio (CAR) decreased marginally to 10.6 percent from 10.7 percent in Q4FY14. Among the profitability measures, return on asset (ROA) in the banking sector declined from 0.9 percent at the end of December 2013 to 0.6 percent at the end of June 2014 due to maintaining higher provision for the increased NPL and the net losses made by SOCBs. Return on equity (ROE) of the banking industry also decreased to 8.4 percent at the end of June 2014 from 11.1 percent at the end of December 2013. The falling interest rate spread during Q1FY15 was a positive development.

6.2 During Q1FY15, capital adequacy ratio (CAR) decreased marginally to 10.6 percent from 10.7 percent in Q4FY14 though still surpassing the minimum 10% regulatory requirement. The CAR for SCBs has remained the same in Q1FY15 as it was in Q4FY14 at 8.7 percent and for PCBs it decreased slightly from 12.1 percent to 12.0 over the period. The ratio for FCBs increased from 20.6 percent in Q4FY14 to 20.8 percent in Q1FY15 (Chart VI.1). The ratio for specialized banks (SBs) deteriorated from (-) 13.7 percent in Q4FY14 to (-) 16.6 percent during Q1FY15.

Chart VI.1: Ratio of total eligible capital to risk weighted assets (CAR)



6.3 The increasing trend which started from Q2FY14 in gross NPL of the banking sector continued during Q1FY15. The ratio increased to 11.6 percent at the end of Q1FY15 from 10.8 percent at the end of Q4FY14 and 8.93 percent at the end of Q2FY14 (Table VI.2 and Chart VI.2). Total outstanding loan increased by 3.4 percent during Q1FY15 over Q4FY14 while total classified loan increased by 11.6 percent over the same period. The deterioration in gross NPL ratio was across the board for all types of banks as the ratios for SCBs, SBs, PCBs and FCBs increased to 23.9 percent, 37.8 percent, 6.3 percent and 7.0 percent respectively at end-September 2014 from 23.2 percent, 33.1 percent, 5.7 percent and 6.2 percent respectively at end-June 2014.

Chart VI.2: Ratio of Gross NPLs to Total Loans

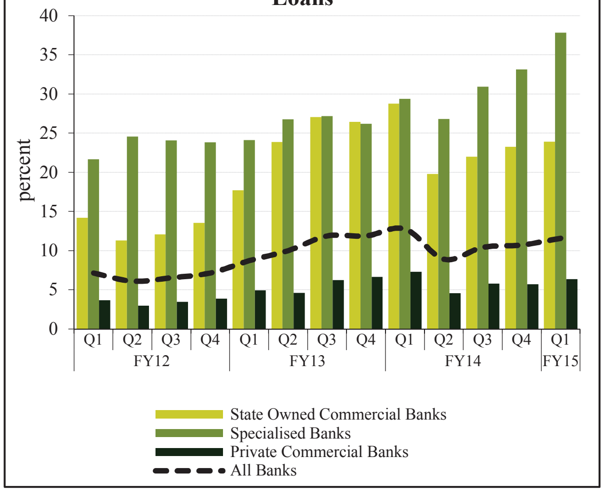
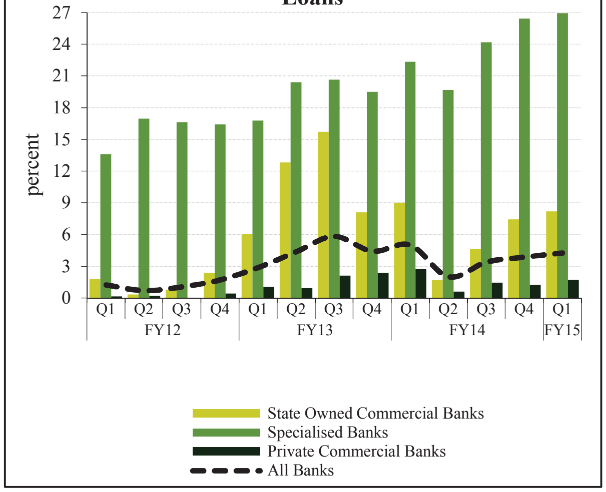


Chart VI.3: Ratio of Net NPLs to Total Loans



Similarly, the net NPL ratio for all banks increased from 3.9 percent at the end of June 2014 to 4.3 percent at the end of September 2014. (Table VI.3, Chart VI.3). Provision shortfall situation of the sector as a whole improved during Q1FY15 and stood at Tk. 29.0 billion which decreased from Tk.40.0 billion at the end of June 2014 (Table 6.1). In Q1FY15 gross NPL ratio for SCBs, SBs and FCBs increased by 0.7, 4.7 and 0.8 percentage points respectively and these groups of banks had provision shortfall of Tk.11.8 billion, Tk.17.9 billion and 2.8 billion respectively. Net NPL ratios for SCBs, SBs, PCBs and FCBs increased from 7.4, 26.4, 1.2 and (-) 0.2 percent respectively at the end of June 2014 to 8.2, 26.9, 1.7 and 0.6 percent respectively at the end of September 2014.

Table 6.1: Comparative Position of Classified Loan and Provision Maintained, FY14

(Tk. in billion)

Quarter	Items	SCBs	SBs	PCBs	FCBs	All Banks
Q2 FY14	Total classified loan	166.1	83.6	143.2	13.0	405.9
	Required provision	107.8	38.2	94.8	11.6	252.4
	Provision maintained	122.3	17.4	97.8	12.3	249.8
	Excess(+)/shortfall(-)	14.5	-20.8	3.0	0.7	-2.6
Q3 FY14	Total classified loan	186.9	97.3	185.3	12.3	481.7
	Required provision	120.6	44.0	107.3	11.1	283.0
	Provision maintained	120.3	17.7	109.1	11.6	258.7
	Excess(+)/shortfall(-)	-0.3	-26.3	1.8	0.5	-24.3
Q4 FY14	Total classified loan	197.2	110.5	191.5	14.2	513.4
	Required provision	124.2	49.3	114.4	12.5	300.4
	Provision maintained	110.7	19.3	117.9	12.5	260.4
	Excess(+)/shortfall(-)	-13.6	-30.0	3.5	0.0	-40.0
Q1 FY15	Total classified loan	208.0	126.6	221.9	16.4	572.9
	Required provision	125.4	56.0	121.8	15.4	318.6
	Provision maintained	113.7	38.0	125.4	12.5	289.6
	Excess(+)/shortfall(-)	-11.8	-17.9	3.5	-2.8	-29.0

6.4 Return on assets (ROA) declined from 0.90 percent at the end of December 2013 to 0.61 percent at the end of June 2014 due to maintaining higher provision for the increased NPL and the net losses made by SCBs. The ROA for SCBs, SBs and PCBs deteriorated from 0.6, (-) 0.4 and 1.0 percent respectively at the end of December 2013 to (-) 0.1 per and0.8 percent respectively at the end of June2014. However, the ratio for FCBs improved from 3.0 percent to 3.5 percent during the same period. Return on equity (ROE) of the banking industry decreased to 8.4 percent at the end of June 2014 from 11.1 percent at the end of December 2013. The ROE for SCBs decreased to (-) 2.4 percent at the end June 2014 from 10.9 percent at the end of December 2013 mainly due to the negative net income of this category of banks. The ratios for PCBs and SBs also deteriorated from 9.8 percent and (-) 5.8 percent to 8.4 percent and (-) 9.5 percent respectively during the period. However, ROE for FCBs improved from 16.9 percent to 20.1 percent during the same period (Table VI.4).

Table 6.2: Deposit and Advance Position of Scheduled Banks (end of the month)

Bank groups	Year-on year growth of deposit (excluding interbank)		Year-on year growth of advances (excluding interbank)		Advance Deposit Ratio (ADR)	
	Sep.14	Jun.14	Sep.14	Jun.14	Sep.14	Jun.14
SCBs	12.5%	13.7%	4.4%	-4.2%	53.5%	53.4%
SBs	12.9%	14.8%	9.8%	13.1%	78.8%	81.6%
PCBs	16.3%	17.6%	15.4%	15.6%	76.4%	77.2%
FCBs	1.8%	7.2%	-4.2%	-1.7%	60.6%	61.4%
All	14.3%	15.8%	11.7%	10.1%	69.9%	70.5%

Table 6.3: Liquidity Position of the Scheduled Banks

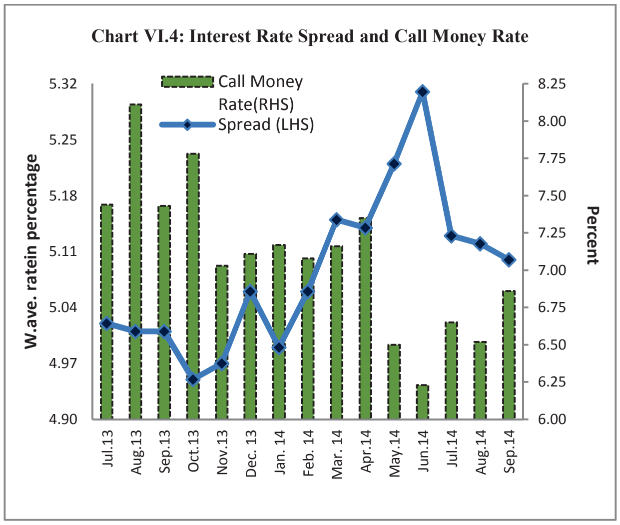
(Tk. in billions)

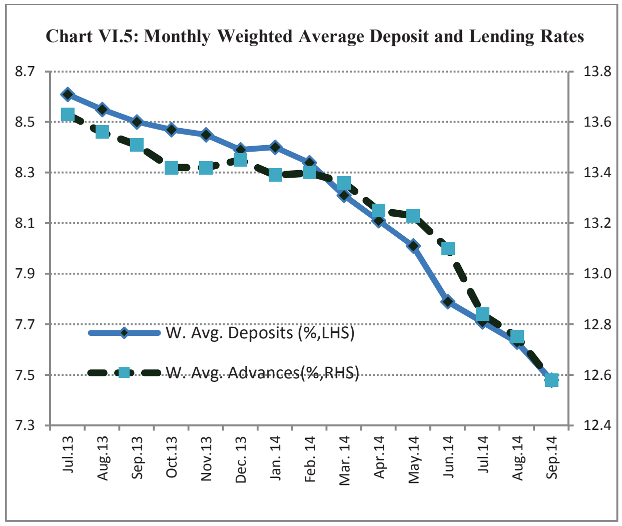
	As of end June, 2014			As of end September, 2014[P]		
	Total Liquid asset	Required liquidity (SLR)	Liquidity in Excess of SLR	Total Liquid asset	Required liquidity (SLR)	Liquidity in Excess of SLR
SCBs	772.4	208.3	564.1	766.1	217.2	559.7
SBs*	49.6	17.7	31.9	46.0	17.3	31.0
PCBs (other than Islamic)	913.0	372.7	540.3	959.0	381.6	580.0
Private Banks (Islamic)	250.3	65.8	184.5	280.8	68.6	208.3
FCBs	161.6	48.4	113.2	191.4	46.1	152.1
All	2146.8	712.8	1434.0	2243.3	730.8	1

* SLR does not apply to Specialized banks (except BASIC Bank) as exempted by the Government.

Note: According to the circular No-MPD-02, 2013 with effect from February 01, 2014 SLR has been calculated separately (excluded CRR) as 13% for conventional banks and 5.5% for Islamic banks of the total demand and time liabilities.

6.5 At the end of Q1FY15, the growth rate (year-on- year) of deposits remained higher than that of advances. As a result, advance-deposit ratio (ADR) remained far below the maximum regulatory ceiling. The growth rate of deposits decreased from 15.8 percent at end of June 2014 to 14.3 percent at end of September 2014. On the other hand, the growth of advances increased from 10.1 percent to 11.7 percent during the period. The advance - deposit ratio (ADR) slightly decreased to 69.9 percent at the end of September 2014 from 70.5 percent at the end of previous quarter (Table 6.2).The liquidity position of the industry as a whole, improved during the first qurter of FY15, leading to a further easing of money market conditions (Table 6.3).





6.6 Monthly interest rate spread for all banks, measured as the difference between monthly weighted average interest rate of advances and deposit, decreased to 5.10 percent by the end of Q1FY15 (Chart VI.4) from 5.31 percent in June 2014. Banks were forced to cut both deposit and lending rates due to low investment demand and easing money market conditions. Bank wise data shows that over the last two quarters of FY14 most banks reduced their weighted average deposit rates more than their weighted average lending rates which caused the increase in spread during this period (Chart VI.5). However, during Q1FY15 lending rates declined faster than deposit rates, as a result interest rate spread decreased over the period. Monthly weighted average call money rate increased from 6.23 percent in June 2014 to 6.86 percent in September 2014.

VII. Capital Market Development

7.1 The performance of capital market in terms of DSE indices and market capitalization improved during Q1FY15. At the end of Q1FY15, DSE broad (DSEX) index and DSE 30 index were at 5074.3 and 1960.9 which were 13.3 percent and 19.2 percent higher respectively compared to those of Q4FY14. Over the same period, market capitalization increased by 15.5 percent (Chart VII.I and Table VII.I). The DSEX index and DSE 30 index grew significantly by 28.9 percent and 36.1 percent respectively in Q1FY15 compared to Q1FY14. DSE market capitalization also rose notably by 39.8 percent during Q1FY15 as compared to Q1FY14.

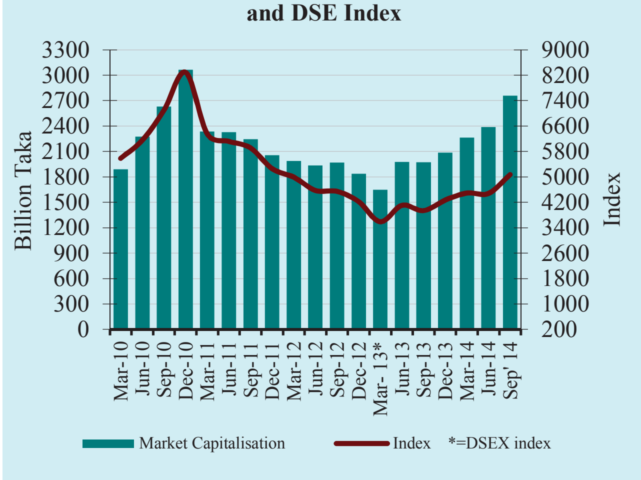


Chart VII.1: Trend in Market Capitalisation and DSE Index

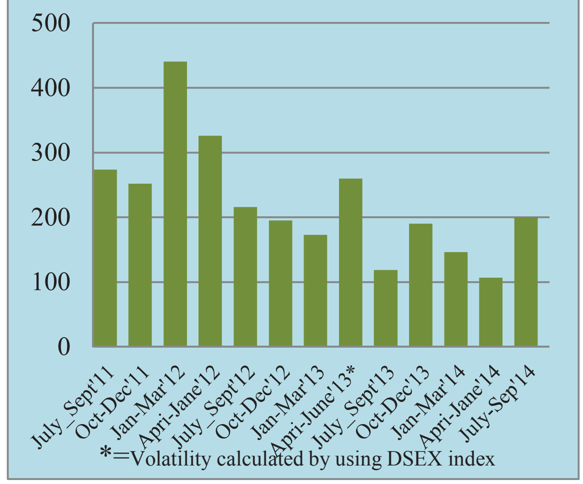


Chart VII.2: Recent Volatility in DSE

7.2 The average price earnings ratio of the DSE increased to 18.64[2] in September 2014 compared to 16.37[3] at the end of June 2014. Total turnover value in the DSE increased significantly by 47.0 percent from TK.233.8 billion in Q4FY14 to TK. 343.6 billion in Q1FY15. In Q1FY15 total turnover value in DSE also increased by 4.8 percent relative to the same period of the previous year. The liquidity situation in the capital market improved as measured by Turnover Velocity Ratio (TVR)[4], which increased to 49.8 percent in Q1FY15 from 39.1 percent in Q4FY14. The number of listed securities increased to 323 in Q1FY15 from 315 in Q4FY14. The value of issued equity and debt increased by 2.1 percent and eight new companies were listed in the capital market during Q1FY15.

7.3 The sector-wise DSE data shows that during Q1FY15 market capitalization increased in all sectors except financial institutions, mutual fund and paper and printing sector (Table VII.2). The contribution of the banking sector decreased to 14.7 percent at the end of Q1FY15 from 16.5

[2] See Page -7, Monthly Review (September 2014, Vol 29, No.09), Dhaka Stock Exchange Limited
[3] See Page -24, BBQ April- June 2014, Bangladesh Bank
[4] TVR= (Turnover During the Quarter/Quarter-end Market capitalization)*4

percent in the previous quarter. The relative contributions of all other sectors remained almost unchanged during the last quarter.

7.4 During Q1FY15 the investment on share purchase by foreign and non-resident Bangladeshi investors plummeted to TK. 9.2 billion from Tk.17.1 billion in the previous quarter. At the same time, total share sales by foreign and non-resident Bangladeshi investors also decreased to Tk. 4.0 billion from Tk. 6.5 billion in the previous quarter. As a result, net investment of foreign and non-resident Bangladeshi during Q1FY15 shrunk to TK.5.2 billion from TK. 10.6 billion in the previous quarter. However, foreign exchange turnover still has a limited contribution in total turnover of DSE. During Q1FY15 total foreign exchange turnover declined to 3.9 percent of total turnover from 10.1 percent of total turnover in the previous quarter. The volatility index, measured by standard deviation, significantly jumped to 200.1 during Q1FY15 compared to 106.6 in Q4FY14.

7.5 Cross country data shows that price earnings ratio and dividend yield of Bangladesh capital market are comparatively higher than most of the South and East Asian countries (Table 7.1). It implies that currently Bangladesh capital market is integrated with the South and East Asian countries.

Table 7.1: Comparison among regional Capital markets- September 2014

Country	Price Earnings Ratio	Dividend Yield
Bangladesh	18.64	3.16
India	18.52	1.26
Sri Lanka	19.69	2.68
Thailand	15.0	2.90
Malaysia	16.00	2.90
Taiwan	18.00	2.90
Hong Kong	16.00	2.60
China	10	3.20
Singapore	13.00	3.30

Source: Page- 7, Monthly Review, Dhaka Stock Exchange